

Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased and owe Use Tax on their cost price of such property. See 86 Ill. Adm. Code 130.220. (This is a GIL).

January 13, 2003

Dear Xxxxx:

This letter is in response to your letter dated October 7, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

I am writing in regards to the sales tax treatment on our lease contracts. Our company previously wrote to you when our business was incorporated, to obtain your interpretation of the tax laws in your state. We are in the process of updating our records and would like an updated interpretation of your leasing sales tax laws. A legal opinion would be most helpful, however, a general answer is needed at a minimum.

Our company leases office equipment such as copiers, computers, faxes, and telephone equipment. We have no offices or employees within your state. All business is conducted from our Iowa office. We purchase the above equipment from a vendor and in turn lease the equipment to a lessee located in your state. The vendor handles delivery and installation for our lessees. Below is a description of our various lease types.

- 1) True Lease Agreement-the lessee has the option of buying the equipment for its fair market value after making all the required payments.
- 2) Rental Agreement-the lease states there is no purchase option but AAA will allow the customer to purchase the equipment after all payments have been received.
- 3) Conditional Sale-the customer purchases the equipment for \$1.00 after all payments have been made.
- 4) Lease Purchase-the lessee can purchase the equipment at the end of the lease for a stated % of AAA's equipment cost.

Please review our enclosed lease agreement and provide us documentation as previously requested, regarding the correct sale tax treatment for the above referenced lease types. We need to know when the sales tax is due, specifically at the time the lease begins or on each monthly lease payment. When or if tax is required to be

collected upfront, on what basis is the tax computed from? Our original equipment cost or the gross receipts of the lease which includes interest?

If you have any questions, please contact me at the above numbers. Thank you for your time and cooperation.

DEPARTMENT'S RESPONSE:

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See subsection (a)(3) of the enclosed copy of 86 Ill. Adm. Code 150.310.

Under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq. There are also some limited exceptions to the general rule described in the preceding paragraphs. There is an exemption from Retailers' Occupation Tax for sales of tangible personal property to lessors who lease that property to governmental bodies under leases of one year or longer. See the enclosed copy of 86 Ill. Adm. Code 130.2012. In addition, the sale of computers and communications equipment and equipment used in the diagnosis, analysis, or treatment of hospital patients is exempt when sold to lessors who lease that property under leases of one year or longer with hospitals to whom the Department has issued a tax exemption identification number. See the enclosed copy of 86 Ill. Adm. Code 130.2011.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.